SUMMARY

Audit of the 2005-2006 Mayor's Proposed Budget

This audit report provides an overview of the 2005-2006 Mayor’s Proposed Budget of $2.816 billion, and makes comparisons to the 2004-2005 Budget, which totaled $3.742 billion. The report also includes our analyses and comments related to revenues, appropriations, and other budgetary aspects of City operations included in the 2005-2006 Mayor’s Proposed Budget.

The Executive Budget Summary for the 2005-2006 Mayor’s Proposed Budget, which contains the budget development process, budget goals, major assumptions, changes, and explanations of the budget was not made available for our audit as of April 21, 2005. In addition, some of the documentation requested from the Budget Department, necessary for our audit, was not provided by April 21, 2005. It appears that the 2005-2006 Mayor’s Proposed Budget was incomplete at the time of our audit and lacked support for some of the major assumptions and changes made.

Our audit was conducted in accordance with Government Auditing Standards issued by the Comptroller General of the United States, except for the completion of an external quality review of the Office of the Auditor General within the last three years.

Overview

The estimated revenues included in the 2005-2006 Mayor’s Proposed Budget consist of Local sources, State sources, and Federal sources in the following amounts and percentages, as compared to the 2004-2005 Budget:

	2005-2006 Estimated Revenues (In Millions)	Percent of Total	2004-2005 Estimated Revenues (In Millions)	Percent of Total
Local sources	$2,145.4	76.2%	$3,062.8	81.9%
State sources	431.5	15.3%	446.4	11.9%
Federal sources	239.5	08.5%	233.0	06.2%
Total	$2,816.4	100.0%	$3,742.2	100.0%

The 2005-2006 Mayor’s Proposed Budget of $2.816 billion is approximately $926 million, or 24.7%, less than the 2004-2005 Budget of $3.742 billion. If the $675 million revenue related to the sale of Water and Sewerage Revenue Bonds in the 2004-2005 budget is factored out of the analysis, the 2005-2006 Mayor’s Proposed Budget provides for a decrease of $250.8 million (8.2%), as compared to the 2004-2005 Budget.

Major Components of the Decrease in Revenues

	Increase/(Decrease) In Millions
Sale of Water and Sewerage Revenue Bonds	$ (675)
Pension Obligation Bonds	(80)
Delinquent Taxes	(65)
Revenue From Operations (Enterprise Agencies)	(64)
Risk Management Sale of Bonds	(61)
Municipal Income Tax	(38)
Internal Reserve Fund (Vehicles)	(28)
Subsidy from General Fund (Enterprise Agencies)	(19)
DDOT State Operating Assistance	(13)
Home Investment Grant	(11)
Sales and Charges for Services	(9)
Supplemental Fee (GDRRA)	(9)
Other State Sources	(9)
Prior Years Municipal Income Tax	(5)
Medicare Reimbursement - EMS	(5)
Community Development Block Grant	(4)
Medicaid Reimbursements	6
Sale of Assets	7
General Obligation Bond Program	8
Library Revenues - Local Source	11
Michigan Occupational Skills Training Grant	12
Other Federal Sources - Net	14
Other Taxes	15
Other Local Sources - Net	24
Wagering Tax (Casinos)	35
Property Tax	37
Net Decrease in Revenues	$ (926)

Major Components of the Decrease in Appropriations

	Increase/(Decrease) In Millions
Salaries and Wages (decreases resulting principally from elimination of 1,978 positions due to layoffs and elimination of vacancies, 10% pay cut through days off without pay for bargaining unit employees, and reorganization of City government)	$ (141)
Employee Benefits (decreases primarily related to elimination of 1,978 positions due to layoffs and vacancies, financing of pension UAAL costs with Pension Obligation Certificates, and renegotiation of employee health benefits)	(136)
Professional and Contractual Services	30
Operating Supplies	8
Operating Services	(12)
Capital Equipment and Outlays	(17)
Fixed Charges	1
Other Expenses (decreases primarily due to $675 million Water and Sewerage Revenue Bonds in 2004-2005 budget, offset by increases for other initiatives)	(659)
Net Decrease in Appropriations	$ (926)

In general, our analysis focused on budget items with General Fund impact. The General Fund appropriations included in the 2005-2006 Mayor's Proposed Budget total $1.410 billion, or 50.1%, of the City's total fiscal year 2005-2006 appropriations, and $168.0 million, or 10.6%, less than the 2004-2005 Budget amount of $1.578 billion.

Revenues:
The five largest components of recurring General Fund revenue, in descending order by budgeted amount, are State Revenue Sharing, Municipal Income Tax, Property Tax, Wagering Tax (Casinos), and Utility Users Tax. A sixth major source of revenue are Bonds, Certificates and Notes Payable.

State Revenue Sharing, budgeted at $285.1 million, was the most stable of the major General Fund revenues. In January 1999, Public Act 532 of 1998 froze the City's revenue sharing payments at $333.9 million, for the period from the State's 1998-1999 fiscal year to the State's 2005-2006 fiscal year, and an annualized amount of State Revenue Sharing for the nine-month period ending June 30, 2007. In order to maintain a balanced State budget, the previous and current governors slashed State Revenue Sharing payments across the board for the State's 2002-2003, 2003-2004 and 2004-2005 fiscal years. The Governor's fiscal year 2005-2006 Executive Budget recommends total State Revenue Sharing payments to Detroit in the amount of $285.1 million, a $2.6 million reduction from the $287.7 million the City budgeted for fiscal year 2004-2005. This is a $48.8 million or 14.6% reduction from the $333.9 million that the City would have received under Public Act 532 of 1998. In our opinion, the amount estimated in the Mayor's 2005-2006 Proposed Budget for State Revenue Sharing is reasonable, because it corresponds with the amount in the Governor's fiscal year 2005-2006 Executive Budget. It should be noted that the Governor's Executive Budget has yet to be enacted and is still subject to change. According to a State of Michigan House Fiscal Agency economist, there are no proposed cuts to State Revenue Sharing.

Municipal Income Tax revenue is estimated at $272.6 million in the 2005-2006 Mayor's Proposed Budget, or $38.4 million (12.4%) less than the 2004-2005 budget amount of $311.0 million. The Budget Department's projection incorporates a 1.3% negative growth rate that was derived from the trend from prior years income tax collections. For fiscal year 2005-2006, the income of residents and nonresidents will be taxed at the rate of 2.5%, and 1.25% respectively while the corporate tax rate will be 1.0%. The tax rates are the same as the prior two years due to suspension of Public Act 500 of 1998. The Municipal Income Tax revenue for fiscal year 2003-2004 (the most recently completed fiscal year) was less than budget estimates by $9.8 million (3.3%). The $275.5 million projection for actual Municipal Income Tax revenue for fiscal year 2004-2005 is $35.5 million or 11.4% less than the budget amount. The Income Tax Division is proposing a reduction in the exemption amount from $750 to $600. The City Council will have to approve the change in the ordinance to change the exemption amount. The Division estimates the change in the personal exemption amount will offset the decrease in income tax revenue by $2.6 million. Based on our analysis of the estimated collections for fiscal year 2004-2005, the stable income tax rate, and the growth rate based on prior years collections, the estimated Municipal Income Tax revenue amount of $272.6 million for fiscal year 2005-2006 appears reasonable.

The 2005-2006 Mayor's Proposed Budget includes $249.6 million for net Property Tax revenue, an increase of $36.5 million (or 17.1%) from the 2004-2005 Budget. The increase is primarily due to the 94.98% collection rate assumption in the 2005-2006 Mayor's Proposed Budget compared to an 84% assumption in the 2004-2005 budget. The collection rate increase is based on the collection of 95.65% of its current Property Tax levy for fiscal year 2003-2004. In fiscal year 2003-2004 the City turned over the collection of unpaid real property taxes to the Wayne County Treasurer's Office. In June of 2004, the Wayne County Treasurer's Office advanced a payment to the City for the unpaid taxes. The City included the advance in its current real Property Tax revenues for fiscal year 2003-2004, which boosted the collection rate. The actual Property Tax revenue for fiscal year 2003-2004 exceeded the budgeted amount by $37.0 million or 17.4%, primarily the result of the advance payment to the City. Based on our analysis the 2005-2006 Mayor's Proposed Budget for Property Tax revenue of $249.6 million is reasonable.

Wagering Tax (Casino) revenue is budgeted at $153.0 million in the 2005-2006 Mayor's Proposed Budget, or $35.4 million (30.1%) more than the $117.6 million included in the 2004-2005 Budget. The Budget Department estimates actual Wagering Tax revenue for fiscal year 2004-2005 at $139.0 million, or $21.4 million (18.2%) more than the $117.6 million budget amount. The fiscal year 2004-2005 estimate includes a 2% increase in the Wagering Tax revenue rate for the City that was not included in the budget assumptions. Public Act 306 of 2004 increased the total Wagering Tax rate paid by the three Detroit casinos from 18% to 24%, with 2% of the additional assessment going to the City of Detroit. Based on our review of the 2005-2006 Mayor's proposed Wagering Tax revenue, the estimate of $153.0 million may be optimistic. The $5.5 million portion of budgeted Wagering Tax revenue, which is based on an additional 1% tax rate increase effective January 1, 2006, is not reasonable. The tax rate increase is not assessable when, "there exists any order or injunction that would deprive a developer of a material portion of the economic benefits anticipated from the casino complex."[1] There is currently a court-ordered injunction in place that prevents the construction of permanent casino sites. If the injunction is lifted before January 1, 2006, this budgeted revenue can be collected.

Utility Users Tax revenue is estimated at $56.0 million in the 2005-2006 Mayor's Proposed Budget, a $1 million or 1.8% increase from the $55.0 million included in the 2004-2005 Budget. The City's actual collections for fiscal year 2003-2004 were $50.5 million or 8.5% less than the $55.2 million budgeted for fiscal year 2003-2004. The Utility Users Tax Act, as amended, provides that the first $45.0 million generated from this tax must be used to retain or hire police officers. The Act also requires that the amount of each fiscal year's Utility Users Tax revenue collected in excess of $45.0 million be dedicated and used exclusively to hire or retain additional police officers, having the rank of sergeant or below, over the level employed on November 1, 1984 of 3,537. A Budget Department representative indicated that the City does not intend to staff police officers at the 3,537 level in fiscal year 2005-2006. Because the City will not use the excess fiscal year 2004-2005 Utility Users Tax revenue to hire and retain additional officers over the 3,537 level, the Utility Users Tax Act requires that the rate of tax imposed be lowered in decrements of ¼ of 1% for each full 5% collected in excess of $45.0 million. Our analysis shows that the City will be required to decrease the tax rate to 4.25% effective October 1, 2005. If it is not the City's intent to use the excess tax revenue to hire and retain uniformed officers above the 3,537 level, the City should adjust its 2005-2006 budget projections for Utility Users Tax revenue downward to reflect a reduction in the rate by ¾ of 1% effective October 1, 2005. This translates into a reduction of approximately $6.3 million, based on the budgeted Utility Users Tax revenue of $56.0 million, in fiscal year 2005-2006.

The 2005-2006 Mayor's Proposed Budget includes $50.0 million in revenues from Bonds, Certificates and Notes Payable, a decrease of $836.7 million from the $886.7 million in the 2004-2005 budget. The 2004-2005 budget included $675.0 million for Water and Sewerage Revenue

[1] Section 3.16 of the Casino Development agreement.

Bonds, $80.1 for Pension Obligation Bonds, $61.1 million for Risk Management Bonds, and $28.5 million for new vehicle purchases. The $50.0 million in the 2005-2006 budget is for voter approved General Obligation Bonds, which is an increase of $8.0 million from the $42.0 million budgeted in fiscal year 2004-2005. These bond proceeds will be used to finance capital improvements. Also, included in the Mayor's 2005-2006 Proposed Budget is a $25.0 million line item - Project Borrowings, listed as a revenue under the Program Management Office. We have been informed that this is a lease/financing arrangement for a new payroll system to be used by the City.

The City issued or plans to issue an additional $1.3 billion of long-term financing in fiscal year 2004-2005, which will raise the amount financed in fiscal year 2004-2005 to $2.2 billion. However, this additional financing is not included in the 2004-2005 budget. The additional financing is detailed below.

Additional Financing	Amount in Millions
Pension Obligation Certificates (POCs)	$ 1,200.0
Pension Obligation Bonds	(80.1)
Bonds for 800 MHz Radio System	87.5
Fiscal Stabilization Bonds	61.0
Revenue Anticipation Notes	55.0
Total Additional Financing 2004-2005	$ 1,323.4

On April 15, 2005, the Finance Director submitted a resolution to issue $87.5 million of capital improvement bonds to finance all of the General Fund costs of an 800 MHz Radio Communications System. It is anticipated that these bonds will be issued in June 2005 although no other details of the issue, such as interest rate or terms, are available as of April 20, 2005.

The Finance Director has also submitted a Resolution to issue Revenue Anticipation Notes not to exceed $55.0 million for the purpose of paying operating expenditures of the City in fiscal year 2004-2005 in anticipation of the collection of State Revenue Sharing and subordinated distributable state aid for the next fiscal year. The notes are to be paid in full by June 30, 2006. These notes were not included in the 2004-2005 Budget, nor was any other information concerning these notes available as of April 20, 2005.

The City annually issues bonds for capital improvements in the $40.0 to $50.0 million range; the amount included in the Mayor's 2005-2006 Proposed Budget is reasonable. Although no documentation was available as of April 20, 2005 to support the assumption that no additional financing over the $50.0 million for capital improvements will be needed, our analysis of projected revenues and expenditures suggests that the City will incur a deficit between $200.0 million and $300.0 million during the next fiscal year, unless draconian measures are undertaken to reduce anticipated expenditures.

Appropriations:

The amount budgeted for Salaries and Wages has decreased by $140.8 million (17.0%) from $830.0 million in the 2004-2005 Budget to $689.2 million in the 2005-2006 Mayor's Proposed Budget. The $140.8 million decrease is the net effect of salary adjustments, transferring the Civic Center and the Department of Transportation, and reductions in the number of budgeted positions. The 2005-2006 Mayor's Proposed Budget includes a decrease of $45.9 million in Salaries and Wages due to 10% salary cuts for the Mayor, appointees, union and nonunion employees. Proposed salary cuts for union employees, excluding Police and Fire, will be accomplished by requiring days off without pay and is contingent upon agreements with the various bargaining units. The Mayor's Budget assumes agreements will be reached with all the bargaining units by the beginning of fiscal year 2005-2006. Salaries and Wages also include $48.6 million in citywide overtime in the 2005-2006 Mayor's Proposed Budget, a decrease of $10.1 million or 17.0% from the 2004-2005 budgeted amount of $58.7 million. Actual overtime has exceeded budgeted overtime in each of the past four fiscal years.

The 2005-2006 Mayor's Proposed Budget decreases Salaries and Wages for the Civic Center by approximately $2.0 million from the 2004-2005 budget. The decrease is based on the assumption that a regional authority will be created to take-over the management of the Civic Center effective January 1, 2006. As a result, the Civic Center is only budgeted for Salaries and Wages through December 31, 2005.

The 2005-2006 Mayor's Proposed Budget decreases Salaries and Wages for the Detroit Department of Transportation (DDOT) approximately $6.4 million. The decrease is based on the assumption that an agreement transferring the management of DDOT to the Detroit Area Regional Transit Authority (DARTA) will be achieved by January 1, 2006.

The assumptions of transferring the management of the Civic Center and DDOT by January 1, 2006 are very optimistic. Budgeted positions for both Departments risk being unfunded, if the planned separations are unsuccessful or do not occur as scheduled.

The 2005-2006 Mayor's Proposed Budget includes 16,765 budgeted positions, 1,978 or 10.6% fewer than the number of budgeted positions included in the 2004-2005 Budget. The decrease in the number of budgeted positions for civilian employees represents 1,315 layoffs, and the net elimination of 663 budgeted positions. The 1,315 layoffs include the 645 employees laid-off in fiscal year 2004-2005 and 670 employees for fiscal year 2005-2006. A total of 718 vacant positions were eliminated and 55 positions were added for a net elimination of 663 positions for fiscal year 2005-2006. The Budget Department was unable to quantify the cost savings associated with the decrease in budgeted positions.

The Budget Department has taken the "cushion" out of the Salaries and Wages budget. With little cushion for Salaries and Wages, and questionable assumptions, the proposed budget is relying on cost savings from employee turnovers to supplant unbudgeted, contract mandated pay increases. The amount budgeted for Salaries and Wages is not reasonable. The assumption that union approval of a 10% pay cut will be approved by July 1, 2005 is doubtful. The assumptions that the Civic Center and the DDOT will separate from the City by December 31, 2005 are extremely optimistic. The assumption that actual overtime will not exceed budgeted overtime is inconsistent with the City's overtime trend.

Employee Fringe Benefits (including Pensions) for the entire City decreased by $136.1 million (or 22.8%) to $461.5 million in the 2005-2006 Mayor's Proposed Budget, as compared to $597.6 million in the 2004-2005 Budget. This $136.1 million decrease is due mainly to a $53.5 million decrease in Pensions ($11.4 million for police and fire uniform employees and $42.1

million for civilian employees) and a $74.3 million decrease in hospitalization costs for active employees and retirees.

The 2005-2006 Mayor's Proposed Budget included $171.1 million for Pension contributions compared to $224.6 million in the 2004-2005 budget. The $53.5 million decrease in employer Pension contributions is primarily due to the anticipated $1.2 billion funding of the General Retirement System (GRS) and Police and Fire Retirement System (PFRS) unfunded actuarial accrued liability (UAAL) at June 30, 2003 with Pension Obligation Certificates (POCs). Without the POCs, the fiscal year 2005-2006 Pension contribution, based on the actuary rates, would have been $258.2 million or $87.1 million (50.9%) more than the 2005-2006 Mayor's Proposed Budget. According to a Budget Department representative, the 2005-2006 Mayor's Proposed Budget includes $69.3 million to cover the fiscal year 2005-2006 estimated debt service (principal and interest) on the POC financing and the amount necessary to amortize the $447.7 million increase in the UAAL between June 30, 2003 and June 30, 2004. We requested supporting documentation for the Pension amounts and POC debt service included in the 2005-2006 Mayor's Proposed Budget from the Budget and Finance Departments. However, as of April 21, 2005 the Budget and Finance Departments had not provided the documentation. Our analysis indicates that the $171.1 million budgeted for pension in the 2005-2006 Mayor's Proposed Budget is not sufficient to fund the City's projected required Pension contributions unless:

- The POC financing is completed prior to June 30, 2005,
- All required contributions to both systems for the current fiscal year are funded by June 30, 2005,
- The projected reduction in the number of employees is realized,
- There are no costs associated with the implementation of the Defined Contribution Plan or with the transfer of former and existing employees from the Defined Benefit Plan to the Defined Contribution Plan, and
- POC financing includes additional amounts for the $447.7 million increase in the UAAL between June 30, 2003 and June 30, 2004; and defers principal, interest, issuance, and administration payments past fiscal year 2005-2006.

The Mayor's proposed $225.8 million for negotiable Fringe Benefits is understated by at least $51.5 million, and may be understated by as much as $100.0 million as follows:

- The $47 million budgeted reduction for savings, based on the assumption that benefit plans will be renegotiated and approved by the unions by July 1, 2005, is unreasonable.
- The assumption that the City will transfer the Department of Transportation (DDOT) to the Detroit Area Regional Transit Authority, and the Civic Center to a newly created regional authority by July 1, 2005 is unrealistic. The amount of negotiated fringe benefit savings identified from these transfers is $4.5 million.

Because the Budget Department was not able to provide us with support for the budgeted Fringe Benefits to use in our analysis, we are unable to conclude whether the $47 million in additional plan costs for fiscal year 2005-2006 were incorporated into the proposed budget. However, it appears that it was not. In early April, Mercer Human Resources Consulting and the Deputy Mayor presented a report on potential cost savings in the employee benefit plans to the City Council. The summary presented included an estimate of the cost of fiscal year 2005-

2006 healthcare benefits. Their estimate, based on financial information provided by the City's vendors, led them to conclude that the cost of healthcare for fiscal year 2005-2006 would be $338.6 million.

Our analysis indicates that health care-related Fringe Benefits are underfunded in the Mayor's Proposed 2005-2006 Budget by a minimum of $51.5 million, and could be underfunded by as much as $100 million. The Proposed Budget recognizes Fringe Benefit cost savings that are unlikely to be fully, or even partially, realized in the 2005-2006 fiscal year.

Reorganization of City Government:
The 2005-2006 Mayor's Proposed Budget includes major organizational changes to City government. Agencies are merged, eliminated, downsized, or transferred in part or whole to other entities. Detailed below are the major changes in agencies and appropriations.

Fiscal Year	Fiscal Year	in Millions		
2005-2006 Department	2004-2005 Department	Appropriation 2005-2006	Appropriation 2004-2005	Increase/ (Decrease)
Executive Agencies				
Arts		$ 0.0	$ 0.0	$ 0.0
Budget	Budget	2.5	3.4	(0.9)
Civic Center	Civic Center	19.0	27.1	(8.1)
Communications	Comm. and Creative Serv.	2.6	3.0	(0.4)
Consumer Affairs	Consumer Affairs	0.0	1.3	(1.3)
Culture, Arts & Tourism	Culture, Arts & Tourism	0.0	2.1	(2.1)
Municipal and Envir. Serv	Dept. of Public Works	234.1	204.5	29.6
Detroit Workforce Dev.	Detroit Workforce Dev.	59.1	43.6	15.5
Environmental Affairs	Environmental Affairs	0.0	2.3	(2.3)
Finance	Finance	30.8	46.2	(15.4)
Fire	Fire	184.2	206.9	(22.7)
Health & Wellness Prom.	Health & Wellness Prom.	85.7	98.1	(12.4)
Historical	Historical	2.3	4.9	(2.6)
Human Resources	Human Resources	23.2	31.9	(8.7)
Human Rights	Human Rights	0.8	2.2	(1.4)
Human Services	Human Services	75.4	74.5	0.9
ITS	ITS	25.3	29.2	(3.9)
Law	Law	17.6	25.3	(7.7)
Mayor's Office	Mayor's Office	8.8	10.5	(1.7)
Economic Development	Planning and Development	62.7	65.2	(2.5)
Police	Police	434.1	488.8	(54.7)
Public Lighting	Public Lighting	0.0	71.5	(71.5)
Community Services	Recreation	29.6	53.5	(23.9)
Senior Citizens	Senior Citizens	0.0	1.4	(1.4)
Zoological Institute	Zoological Institute	12.8	17.1	(4.3)
Administrative Hearings	Administrative Hearings	2.5	2.3	0.2
Homeland Security	Homeland Security	3.1	0.7	2.4
General Services		31.4	0.0	31.4
Total Executive Agencies		$ 1,347.6	$ 1,517.5	$ (169.9)
Legislative Agencies				
Auditor General	Auditor General	$ 2.1	$ 3.1	$ (1.0)
Board of Zoning Appeals	Board of Zoning Appeals	0.7	0.9	(0.2)
City Council	City Council	12.1	16.9	(4.8)
Ombudsperson	Ombudsperson	0.8	1.5	(0.7)
City Clerk	City Clerk	3.5	4.3	(0.8)
Department of Elections	Department of Elections	9.7	11.1	(1.4)
Total Legislative Agencies		$ 28.9	$ 37.8	$ (8.9)

Fiscal Year	Fiscal Year	in Millions		
2005-2006 Department	2004-2005 Department	Appropriation 2005-2006	Appropriation 2004-2005	Increase/ (Decrease)

Judicial Agency				
36th District Court	36th District Court	$ 38.8	$ 49.4	$ (10.6)
Other Agencies				
Non-Departmental	Non-Departmental	360.9	330.4	30.5
Total General City Agencies		$ 1,776.2	$ 1,935.1	$ (158.9)
Debt Service	Debt Service	62.9	70.6	(7.7)
Enterprise Agencies				
Airport	Airport	$ 1.1	$ 5.7	$ (4.6)
Buildings and Safety Eng.	Buildings and Safety Eng.	37.7	37.1	0.6
DDOT	DDOT	149.4	171.2	(21.8)
Municipal Parking	Municipal Parking	43.8	48.2	(4.4)
Water	Water	303.3	700.7	(397.4)
Sewerage	Sewerage	392.9	730.4	(337.5)
Library	Library	49.1	43.2	5.9
Total Enterprise Agencies		$ 977.3	$ 1,736.5	$ (759.2)
Grand Total		$ 2,816.4	$ 3,742.2	$ (925.8)

The following five departments are eliminated and the services transferred to other departments:

- Consumer Affairs
- Culture, Arts & Tourism
- Environmental Affairs
- Public Lighting
- Senior Citizens

Public Lighting, Environmental Affairs, and Public Works are combined to form the new Municipal and Environmental Services Department. The new Community Services Department includes the former Recreation, Senior Citizens, and part of Human Services (Youth Advocacy) Departments. The Planning and Development Department is renamed the Economic Development Department.

The 2005-2006 Mayor's Proposed Budget includes transferring DDOT management to the Detroit Area Regional Transportation Authority (DARTA). Food sanitation inspections and licenses responsibility are to be transferred to Wayne County. A new Convention Center Authority is to be formed to operate Cobo Hall, which will result in the elimination of the Civic Center Department. The Detroit Zoological and Historical Societies will respectively operate the Zoological Institute and Historical Departments.

The new General Services Department will centralize all building, grounds, and fleet (except DDOT) maintenance and services that were previously handled by the various City agencies.

Current Year Projection:
The Budget Department currently projects a General Fund Deficit of $67.3 million for fiscal year 2004-2005 based on its most recent analysis of various General Fund appropriations and

revenues. The Budget Department's Surplus/Deficit Estimate Report for fiscal year 2004-2005 includes a total deficit of $89.0 million less $21.7 million for deficit reduction measures that included: vendor concessions ($4.0 million); non-union DOWOP ($1.6 million); preliminary encumbrance review ($6.0 million); and miscellaneous cuts ($10.1 million). The Budget Department did not provide us with the fiscal year 2004-2005 General Fund Estimated Surplus/Deficit Report until April 21, 2005. We could not fully analyze the Budget Department's estimated deficit, as the deficit reduction measures were not detailed and the Budget Department did not provide any supporting documentation or other explanation for them. As a result, the $67.3 million estimated deficit is questionable.

Other:
Other items of financial importance and interest related to the 2005-2006 Mayor's Proposed Budget include the following:

1. Budget Stabilization Reserve Fund
   By the end of fiscal year 2003-2004, the Budget Stabilization Reserve Fund, the "Rainy Day Fund," was reduced to $0.0, as the City used the funds to cover the deficit incurred in fiscal year 2002-2003.

2. Risk Management Fund
   The calculation of the Risk Management Fund premium in the Mayor's 2005-2006 Proposed Budget does not follow the methodology used in the past. Historically, the amount of the annual claims premium has been based on a five-year running average of actual payouts for damage claims and lawsuits. The five-year historical average for the General Fund and the Department of Transportation is $60.7 million. The Mayor's Proposed Budget includes a $12.5 million deduction from the five-year average payout due to the City's expected fiscal year 2005-2006 savings from hiring an outside agency to help the City reduce its exposure to future claims and judgments. The Budget Department was unable to provide information concerning the proposed contractor or how the cost savings of $12.5 million was calculated. Reducing the risk management premium for future savings is a change in the methodology used to calculate the premium. We disagree with the departure from the historical methodology of basing the risk management fund premium calculation exclusively on a five-year running average of actual payouts on damage claims and lawsuits.

   The current balances of the 2003 and the 2004 self-insurance bond issues are $98.9 million and $62.3 million respectively, for a total of $161.2 million. Each of these bond issues mature over a ten-year period and should be paid off in fiscal years 2012-2013 and 2013-2014, respectively. The estimated annual average cost of debt service on the 2003 bond issue and the 2004 bond issue combined is $21.1 million over a period of ten years.

3. Detroit Department of Transportation (DDOT)
   The 2005-2006 Mayor's Proposed Budget assumes the management of DDOT will be transferred to the Detroit Area Regional Transportation Authority (DARTA) by January 1, 2006 saving the City approximately $10.0 million in personnel costs. The 2005-2006 Mayor's Proposed Budget for DDOT compared to the 2004-2005 budget includes:

- 182 fewer positions, primarily bus drivers, due to layoffs, transfers, and elimination of vacant positions;
- $15.1 million less for the City's General Fund subsidy due to reduction in operating costs and transfer to DARTA;
- $12.5 million less for State Operating Assistance because of a reduction in DDOT operating expenses and 5.1% reduction of the State's reimbursement percentage, which is estimated to cost DDOT $7.3 million in fiscal year 2005-2006;
- $3.0 million in additional farebox revenue for the reinstatement of the disabled rider fare, which is overly optimistic;
- $9.5 million budgeted for overtime, which is $3.2 million or 25.2% less than the $12.7 million budgeted in fiscal year 2004-2005 and much less than the $21.4 million actual overtime paid in fiscal year 2003-2004; and
- $1.9 million increase for vehicle maintenance primarily due to the reinstatement of 32 coach service attendant positions that were eliminated from the 2004-2005 budget.

The State is currently withholding approximately $1 million per month from the DDOT in operating assistance because the DDOT is not in compliance with ADA requirements to maintain vehicles with operable wheelchair lifts. A DDOT representative told us they could lose a total of $6.8 million if they are not in compliance by the end of fiscal year 2004-2005.

DDOT operating expenses and net operating losses, continue to grow. Net operating expenses increased $46.0 million or 28.6% over the past six fiscal years while net operating losses increased $52.7 million or 40.8% during the same period. Net operating losses should be reduced in fiscal year 2004-2005 and in fiscal year 2005-2006 because of layoffs and other cost reduction efforts. However, the 2005-2006 Mayor's Proposed Budget for the reduction of DDOT operating expenses is extremely optimistic.

Based on our analysis, the 2005-2006 Mayor's Proposed Budget for DDOT is not reasonable. Farebox revenues are overstated. Based on past history, operating expenses, including overtime, are understated. If the transfer of the DDOT management to DARTA does not take place as planned by January 2006, then DDOT operating expenses will be significantly higher requiring additional General Fund support.

4. <u>Detroit Transportation Corporation (People Mover)</u>

The Detroit Transportation Corporation (DTC) is partially funded by grants from the City. The 2005-2006 Mayor's Proposed Budget for DTC compared to the 2004-2005 budget includes:

- $1.5 million decrease in the General Fund subsidy to $6.2 million for 2005-2006;
- $3.0 million in State Operating Assistance for the first time, which will be used for general operations;

- $2.3 million reduction in the Federal Transit Administration (FTA) Grant to $1.6 million in fiscal year 2005-2006; and
- $10.0 million from the City's sale of General Obligation Bonds, which will be used for vehicle mid-life overhaul ($9.6 million) and for replacement of station escalators and elevators ($.4 million).

5. <u>Municipal Service Fee</u>
   The 2005-2006 Mayor's Proposed Budget includes $15.3 million for the three casinos' municipal service fee, which is $1 million more than the $14.3 million included in the 2004-2005 budget. The 2005-2006 Mayor's Proposed Budget also includes $12.4 million of municipal service fee appropriations, which is $1.9 million less than the 2004-2005 budget. The decrease is due to a reduction in the number of police officers and Fire and Emergency Medical Service (EMS) workers. The fiscal year 2005-2006 municipal service fee appropriations provide for 96 police officers and 44 Fire and EMS workers. Based on our analysis of the 2005-2006 Mayor's Proposed Budget for municipal service fees, the $15.3 million revenue and $12.4 million appropriations appear reasonable.

6. <u>Employee Turnover Savings</u>
   Employee turnover savings is the dollar estimate of the savings in appropriations resulting from positions included in the budget that may not require funding during some period of the fiscal year. The total estimated employee turnover savings projected for fiscal year 2005-2006 is $30.9 million or a $6.1 million (19.7%) increase from the 2004-2005 Budget of $24.8 million. Our analysis indicates that there are 16,765 budgeted positions included in the 2005-2006 Mayor's Proposed Budget but funding for only 16,357 positions (16,765 - 408), as compared to the 2004-2005 Budget, in which there was funding for 18,417 positions (18,705 - 288).

<u>Conclusion</u>
In our opinion, the 2005-2006 Mayor's Proposed Budget is incomplete and contains assumptions that are not properly supported and are extremely optimistic. The layoffs and reductions in the number of positions are necessary but too late. As a result, the 2005-2006 Mayor's Proposed Budget is unrealistic and unattainable. We identified the following:

- The assumption that the management of DDOT and the Civic Center will be transferred by December 31, 2005 is extremely optimistic considering the net costs and inefficiencies they carry. There was no documentation provided to support the Budget Department's assumptions used to compute the reduction in costs to the City associated with the transfer of these two agencies for fiscal year 2005-2006. Finding another entity willing to take on these agencies in their current state is unlikely, unless the City continues to fully subsidize them.
- The assumption that civilian bargaining units will accept days off without pay by July 1, 2005 to reduce the payroll by 10% is extremely optimistic. The alternative of more layoffs and reduction of City services may be more realistic.
- The assumption that bargaining units and retirees will renegotiate health benefits by July 1, 2005 is extremely optimistic. There was no documentation supporting the Budget Department's assumptions used to compute the reduction in health benefit costs for fiscal year 2005-2006.

- Transferring the Zoological Institute and Historical Department to their respective societies by July 1, 2005 is optimistic. It may take some time before the Zoological and Historical Societies can raise the necessary operating funds to replace the City's contributions.
- The costs to implement the Defined Contribution (DC) plan in fiscal year 2005-2006 are not included in the Mayor's Proposed Budget. While the DC plan should produce cost savings in the long run, in the short term, it could result in substantial costs to the City as a result of lowering vesting requirements to four years.
- The Budget Department did not provide us with requested documentation supporting the Budget Department's assumptions used to compute the reduction in pension costs for fiscal year 2005-2006. The 2005-2006 Mayor's Proposed Budget for pension costs are not properly supported and appear to be significantly understated.
- The Budget Department did not provide us with documentation on how the fiscal year 2005-2006 cost savings of $12.5 million for the Risk Management Fund was calculated. The methodology used to calculate the fiscal year 2005-2006 premium was not consistent with past years. Also, the $12.5 million in savings is recognized before the contractor is even hired to identify and achieve the savings. As a result, the 2005-2006 Mayor's Proposed Budget for the Risk Management Fund premium is understated.
- The Budget and Finance Departments did not provide us with any supporting documentation, such as the interest rate, term, debt service, and administration costs for fiscal year 2005-2006 associated with the $1.2 billion Pension Obligation Certificates, $87.5 Bonds for the 800 MHz Radio System, and $55.0 million Revenue Anticipation Notes.
- The Mayor's Proposed Budget includes a total of $21.1 million in additional revenues that will need State legislative changes and/or voter approval. These are: $6.3 million in Utility Users Tax; $12.3 million in Prepared Food Tax; and $2.5 million in Property Transfer Tax.
- The Mayor's Proposed Budget relies on a personal income tax exemption decrease from $750 to $600 to generate an additional $2.6 million.
- Additional Wagering Tax Revenue of $5.5 million, based on a 1% increased tax rate scheduled to begin January 1, 2005 cannot be assessed until the court-ordered injunctions against building permanent casinos are lifted. This revenue is included in the Mayor's Proposed Budget.